MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, IN 46204

December 9, 1999

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dr. Teresa Ghilarducci
Steven Miller
Jonathan Birge

OTHERS PRESENT

Steffanie Rhinesmith, Indiana Development Finance Authority
Mary Beth Braitman, Ice Miller Donadio & Ryan
Kris Ford, Wm. M. Mercer Investment Consulting
Nicole Stallbaumer, Wm. M. Mercer Investment Consulting
Pete Keliuotis, Wm. M. Mercer Investment Consulting
Richard Boggs, Burnley Associates
Doug Todd, McCready & Keene, Inc.
Elaine Beaty, McCready & Keene, Inc.
Karen Franklin, National City Bank
Jerry Handfield, Commission on Public Records
Kelly K. Jones, Commission on Public Records/Intelenet Commission
E. William Butler, PERF Executive Director
Mark Webb, PERF Deputy Director & General Counsel
Patrick Lane, PERF Executive Assistant
Diann Clift, PERF MIS Director
Bill Hutchinson, PERF Division Director, Pension Administration
Dave Yeater, PERF Division Director, Finance
Yvonne Collins, PERF Administrative Assistant, Pension Administration
Terry Partain, PERF Administrative Assistant, Finance
Alice Cartwright, PERF Pension Administrator
Karen Vise, PERF Supervisor, Pension Administration
Marty Montgomery, PERF Supervisor, Pension Administration
Carolyn Cook-Cazzell, PERF Clerk, Pension Administration
John Brown, PERF Accountant
Linda Stahl, Recording Secretary

ITEMS MAILED TO THE BOARD PRIOR TO MEETING

A. Agenda of December 9 & 10, 1999 Meeting

B. Minutes:

- August 30 & 31, 1999 Board of Trustees Meeting
- October 22 & 23, 1999 Board of Trustees Meeting
- September 22, 1999 Benefits Administration Committee Meeting
- November 10, 1999 Benefits Administration Committee Meeting
- October 8, 1999 Investment Committee Meeting
- October 15, 1999 Investment Committee Meeting

C. Statements of Retired and Disabled Members – PERF, Judges, Conservation & Excise, and Police & Fire

D. Reports, Summaries, Memorandums and/or Letters Concerning:

- Consolidated Retirement Investment Fund Quarterly Performance
- Investment Policy Compliance
- Actuarial Employer Contribution Rates Smoothing
- New/Pending Litigation
- Quarterly Financial Statement
- Quarterly Statistical Statement
- Year 2000 Project Update
- New Units & Enlargements

A quorum being present, Chair Doermer called the meeting to order.

1. MINUTES APPROVAL

MOTION duly made and carried to approve the Minutes of the August 30 & 31, 1999 meeting with the following change:

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Investment Committee Report

A. Duration Rebalancing

Both ~~S&P~~ Fixed Income funds have slipped out of compliance with the duration for the Index. Committee consensus was that the funds should be brought back in line as opportunities present themselves --- there will be no major transactional changes in order to bring the funds back into conformity with the duration. Once permanent managers have been selected, the issue can then be resolved.

Proposed by: *Steve Miller*
Seconded by: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstentions*

MOTION duly made and carried to approve the Minutes of the October 22 & 23, 1999 meeting.

Proposed by: *Jonathan Birge*
Seconded by: *Nancy Turner*
Votes: *5 for, 0 against, 0 abstentions*

2. BOARD DISCLOSURES

Richard Doermer - Banc One Corporation and its affiliates (Stock ownership)

3. ADMINISTRATIVE

Board Recognitions

MOTION duly made and carried to recognize the following individuals for giving fully of their energy and time in the repair and restoration of the Harrison Building and PERF records following considerable water damage sustained in January 1999 due to the breakage of water pipes:

PERF Staff

John Brown
Alice Cartwright
Diann Clift
Yvonne Collins
Carolyn Cook-Cazzell
Patrick Lane
Marty Montgomery
Terry Partain
Karen Vise

Others

Don Feeback, Revel Henry & Underwood (Building Managers)
Jerry Handfield, Commission on Public Records
Kelly Jones, Commission on Public Records (current Intelenet Commission employee)
Larry Lafollette, Commission on Public Records

Proposed by: *Steve Miller*
Seconded by: *Nancy Turner*
Votes: *5 for, 0 against, 0 abstentions*

Election of Officers

MOTION duly made and carried to reappoint Richard Doermer to the position of Chair and Nancy Turner to the position of Vice Chair.

Proposed by: *Teresa Ghilarducci*
Seconded by: *Steve Miller*
Votes: *3 for, 0 against, 2 abstentions (Doermer & Turner)*

Committee Appointments

MOTION duly made to reappoint the Benefits Administration Committee consisting of Jonathan Birge and Nancy Turner.

MOTION duly made to expand the current Investment Committee consisting of Steve Miller and Teresa Ghilarducci to include Jonathan Birge.

MOTION duly made and carried to transform the current Budget Committee to the Budget and Audit Committee consisting of Richard Doermer and Nancy Turner.

Proposed by: *Teresa Ghilarducci*
Seconded by: *Jonathan Birge*
Votes: *5 for, 0 against, 0 abstentions*

Executive Director's Report

Different members of the Board of Trustees have raised concern with respect to the lack of an internal audit function within PERF. Accordingly, the Executive Director has undertaken discussions with a professional consulting firm with whom the Fund is currently doing business. They were asked to consider the idea of helping create and flesh out the function of an Internal Auditor, and secondly to help draft and put in final form a set of internal controls, including whatever policies, rules, etc. would be required. Lastly, they were asked to help with an initial audit plan that would include the first set of projects for an Internal Auditor as well as an implied schedule. The firm has responded with a proposal, and their suggested costs are well within the amount of money the Fund has in its budget specifically dedicated to an internal audit. A meeting will be scheduled within the next two weeks to discuss the issues involved, and if an agreement can be reached, work should begin by February 1.

One of the things this firm has been asked to be aware of is the fact that the new Clarety project contains a lot of audit and cross checks and functionality that would be useful to a general audit program, and they need to be able to work in parallel with it and integrate their efforts with the project. They have also been asked to set up the audit program in such a way that it could one day be turned over to an incumbent.

The Executive Director will have a report on this matter at the next meeting of the Board of Trustees.

Year 2000 Update

Efforts have been underway to ensure that PERF is Y2K ready. Both the IRIS and FAMIS systems have been tested and are now back in production with all remediation efforts completed. All agency software has been upgraded, and all agency hardware has been replaced and compliance efforts completed. With respect to impacted systems (fire alarms, elevators, card entry systems, etc.) some minimal remediation has been completed, and all systems are now compliant. All compliance efforts for contracts have also been completed.

Concerning contingency planning, staff will be monitoring both the IRIS and FAMIS systems over the New Year's holiday. Diann Clift will be in the office on New Year's Day to ensure that all user PC's and servers are operational. Additionally, various Department of Information Technology staff will be on call over that weekend to monitor the State network as well as the mainframe and agency servers for any problems. Both Bill Hutchinson and Dave Yeater have developed contingency plans for their business function areas. As the majority of PERF business functions are dependent upon the computer, efforts have been primarily focused on identifying and resolving computer issues. Contingency plans have been made for processing benefit checks in the event of a major computer failure.

West Market Street Properties Update

> 125 West Market Street – The Data Processing Oversight Commission ("DPOC"), previously two months in arrears, is now one month in arrears in rent payments. PERF's building manager, Revel & Underwood, is working to resolve the issue. No unusual maintenance expenses were incurred during the last quarter. Non-operating expenses were better than budgeted. Total income was worse than budgeted due to the DPOC delinquency in rent payments.
>
> Harrison Building – As of September, the building reached 80% occupancy with the addition of the Indiana State Teachers' Claim Division. With the expansion completed for the Governor's Planning Council for People with Disabilities, the building will be approximately 95% occupied, and PERF will probably use that remaining 5% for peripheral activities. No

unusual maintenance expenses were incurred. Total and net operating incomes were significantly worse than budgeted for most of the quarter due to the expansion of PERF into additional space, creating a bulk of unused office space for the period of reconstruction. Two non-operating expenses of $31,614.83 (partial payment of 5th floor tenant improvements) and $942.50 (consulting fee for 8th floor fire suppression system) were incurred during the quarter.

It was also noted that pursuant to Board direction, staff is currently in the process of setting up a limited liability corporation that will hold title to the real estate assets of the Fund. It is expected the establishment of the corporation will be completed by December 31.

New Units & Enlargements

MOTION duly made and carried to approve the following new units & enlargements:

New Units

1696	-	Town of Arcadia
1697	-	Pleasant Township
1698	-	Prairie Township
1699	-	Seward Township
1700	-	North Daviess Community Schools
1701	-	Charlestown Township, Clark County
1702	-	Jackson Township, Harrison County
1703	-	Town of Lewisville
1704	-	Region 8 Education Service Center
1705	-	White River Township Fire Protection District

Enlargements

0516	-	North Madison Co. Public Library
0671	-	Greentown Public Library
0865	-	City of Angola
0883	-	Whitley County
1009	-	North Newton School Corporation
1019	-	Maconaquah School Corporation
1055	-	City of New Haven
1097	-	MSD Pike Township
1132	-	North Gibson School Corporation
1180	-	South Ripley Community School Corporation
1199	-	Marion-Adams Schools
1201	-	Seymour Community Schools
1215	-	Town of Plainfield

1224-001 - Brown County Solid Waste Management District
1238 - Western Wayne Schools
1242 - Town of Geneva
1385 - Henry Township
1393 - Mooresville Consolidated School Corporation
1448 - City of Batesville
1483 - City of Rising Sun
1533 - Clay Township Hamilton County
1540 - Lawrenceburg Public Library
1551 - City of Connersville
1559 - Central Nine Career Center
1563 - City of Noblesville
1569 - Hussey-Mayfield Memorial Public Library
1636 - Peabody Public Library
1648 - Town of Shelburn

Proposed by: *Jonathan Birge*
Seconded: *Teresa Ghilarducci*
Votes: *5 for, 0 against, 0 abstentions*

4. LEGAL

New/Pending Litigation

Mark Webb updated the Board with respect to pending litigation as follows:

Shepherd, et. al. v. PERF – Suit filed against the Conservation & Excise Fund based on calculation of benefits for those officers with more than 25 years of service. A hearing on summary judgment was held on Friday, December 3. The Court seemed to understand the issues, and the judge indicated he would make his own ruling within two weeks.

Vanderploeg v. PERF, et. al. – Suit filed by a firefighter applicant who was rejected for hire by the Franklin Fire Department because he was blind in one eye and could not pass the Baseline Physical Standards. The Plaintiff has filed an amended complaint ---- PERF has not yet filed an answer to that complaint.

Mahowald v. PERF, et. at. (Indiana Court of Appeals) – The Court of Appeals upheld the constitutionality of the Legislators' Retirement System.

Mr. Webb also noted that the case involving the two individuals from Evansville whose conditional offers of employment were revoked by the Police Pension Board because they did not meet the minimum Baseline

Mental Standards has progressed no further than previously reported to the Board.

Also, PERF recently received notice that they have been named as a party defendant in another suit filed in Evansville. This suit was filed by the Fraternal Order of Police against the City of Evansville's Police Department and the 1977 Police Officers' & Firefighters' Pension & Disability Fund. The basis of the suit is that the City of Evansville wrongfully calculates first class salary, which is what a benefit in the '77 Fund is based on, and that PERF, therefore, wrongfully pays a benefit based on an incorrectly calculated first class salary. This case is so new that nothing has been filed in the matter.

McCray Memorial Hospital

By way of background, McCray Memorial Hospital joined PERF in the late 1970's. Somewhere in the mid-1990's they began to experiment with a home health care program in Noble County and hired a significant number of people. Because of problems that arose, they ended up terminating those individuals within a span of 2-3 years. Most of those individuals were refunded their annuity savings account money, thereby forfeiting all service credit. During this period of time, McCray experienced severe financial losses and began to make overtures about pulling out of PERF. Resolutions to withdraw were filed with PERF; however, McCray failed to follow through. Beginning then with the second quarter of 1996, McCray became delinquent in employee/employer contributions. That continued for a period in excess of one year. Following discussions between PERF and the Hospital, employee contributions were made current; however, employer contributions have remained unpaid. Since that time McCray has again filed a Resolution for Withdrawal. Statute (IC 5-10.3-6-8) directs the Board to calculate the funding level of a withdrawing unit to ensure there are adequate reserves to pay the accrued benefits. The unusual thing that arose in the McCray situation was that in terms of employee payments, there was a deficit ($2.6 Million). However, in terms of the funding of the liabilities, there is an excess ($9.7 Million).

At the last meeting of the Board, McCray made a personal appearance and reiterated their position that the Hospital was actually overfunded. In light of that and the fact that McCray will no longer exist after December 31, 1999 due to a pending merger with Parkview Hospital, they requested that the Board of Trustees absolve them of any obligation with respect to the delinquent contributions. The Board was then unwilling, based on the information they had at that time, to affirm a withdrawal. Therefore, the issue was directed back to PERF staff and consultants to determine the most appropriate course of action in light of the actuarial requirements. Extensive work was completed, including contacting the State Board of Accounts ("SBA") to request an audit position. The SBA responded: "We would not take audit exception if the PERF board, after receiving guidance from their legal advisors, develop policies and procedures to allow an offset between a withdrawing unit's over funded basis with PERF and the outstanding contributions. Such policy would have to consider the requirements of IC 5-10.3-6-8."

Following discussion, the Board noted that while they do not agree with the notion of offsetting the debt, these are special circumstances. Therefore, following review of the State Board of Accounts' response on the matter and looking at the potential collectability of the debt:

MOTION duly made by Steve Miller, seconded by Jonathan Birge and carried to delegate authority to the PERF staff to negotiate the best solution in this matter.

Proposed by:	*Steve Miller*
Seconded by:	*Jonathan Birge*
Votes:	*5 for, 0 against, 0 abstentions*

Note was made that had PERF had the necessary staffing resources, a situation of the nature of McCray would not have arisen. Looking forward, the possibility of another such situation should be greatly eliminated with the inception of the new Clarety computer system.

5. BENEFITS

Benefits Administration Committee Report

Two items discussed at previous meetings of the Benefits Administration Committee were presented to the Board as follows:

a. Smoothing Resolution

MOTION duly made and carried to adopt Resolution No. 99-07 for smoothing actuarial employer contribution rates (Exhibit A).

Proposed by:	*Teresa Ghilarducci*
Seconded by:	*Steve Miller*
Votes:	*5 for, 0 against, 0 abstentions*

b. Pension Relief Issues

When the 1977 Police & Fire Fund was implemented, also included was a relief mechanism called Pension Relief which was initially funded by cigarette and alcohol taxes and annual appropriations from the General Assembly. Those monies were to be invested and over time disbursed to the local units to help them pay their old unfunded pension liabilities. Subsequently, a $10 Million lottery appropriation has been added to that and cigarette and alcohol taxes have been increased.

Statute delegates the authority for running the Pension Relief Fund to the PERF Board of Trustees. Subsection 4 of that statute states that in order for a unit to be eligible for a distribution, it has to provide a specific amount of information to PERF before April 1 of each year. Statute then goes on to provide that a unit is ineligible for a distribution if it does not provide the required information to PERF before April 1 or at least a substantial amount of that information along with an affidavit from the Chief Executive Officer of the unit detailing what steps have been taken to obtain the remaining information. There has been a recurring problem in obtaining that information from a number of units, and no distribution can be made to any unit until all have reported. What that means is that if the City of Indianapolis does not submit the information by April 1, PERF does not have the correct information called for by statute and calculations cannot be completed for any of the units. Historically, PERF has had to contact those units to secure the necessary information and complete the calculations. Statute has never been imposed and a distribution withheld. However, PERF staff is hard pressed to complete those calculations and prepare checks for mailing because of the tardiness of some units in reporting the necessary data.

The Benefits Administration Committee previously requested Mark Webb, Bill Butler and Mary Beth Braitman (Ice Miller Donadio & Ryan) to look at ways in which this matter can be resolved. Having heard the issues, the Board by consensus encouraged PERF staff to do everything within their means to obtain the information necessary to make pension relief calculations/distribution and to work toward legislative change for resolution of the matter.

6. ACTUARIAL

Valuation Report

Doug Todd, representing McCready & Keene, was present with a discussion of the 1977 Police & Fire Fund actuarial valuation (report on file).

Mr. Todd noted that one of the benefits incurred with the recent Constitutional change allowing PERF to invest in equities was that a higher rate of interest could be assumed in the completion of actuarial valuations. That tends to lower costs. Thus, the 21% interest rate assumption used for the Police & Fire Fund since the plan's inception in 1977 could have been lowered. However, following a meeting with representatives of the 1977 Fund, PERF, and Indiana Association of Cities and Towns, it was decided that the 21% would be maintained. With the retention of that rate, the plan provisions would be slightly improved. Thus, it was Mr. Todd's recommendation that a 21% interest crediting rate be maintained for the 1977 Police & Fire Fund.

MOTION duly made and carried to accept the 1977 Police & Fire Fund actuarial report as presented.

Proposed by: *Jonathan Birge*
Seconded by: *Nancy Turner*
Votes: *5 for, 0 against, 0 abstentions*

7. FINANCIAL

Quarterly Financial Statement

The third quarter statement of administrative expenses reflected a budget of $1,314.806.25 with expenses of $1,232,438.20. Therefore, comparison of actual expenses to budget reflects a positive net of $82,368.05.

Quarterly Statistical Statement

In an effort to capture a statistical picture of all funds administered by PERF, staff has begun tracking certain data as follows:

- Member/Beneficiary Benefits
  - Total number of retirement/disability benefits paid
  - Total amount of retirement/disability payments made
  - Average monthly retirement/disability benefit
  - Average age at retirement/disability
  - Average years of service for retirement/disability
- Contributions
  - Employer/employee contribution amounts
- Refunds
  - Number of refunds received and paid
- Annuity Savings Account Investment Options
  - Number of option forms processed
  - Number of members making more than one option selection
  - Number of members participating in each investment option
  - Amount of monies invested in each option

8. INVESTMENTS

Investment Compliance Report

Richard Boggs, Burnley Associates, began the investment compliance report by noting that all investment managers appeared to follow the investment styles for which they were hired. No violations of Guidelines were detected.

With respect to asset allocation, steady progress continues to be made towards achieving the long-term goals of the Fund. Monies are being shifted from bonds to stocks at the rate of $120 Million per month. Allocations on September 30 were 42% Large Cap, 7% Small Cap Domestic Equities, and 51% Domestic Bonds.

Concerning proxy voting, the procedure by which the custodian bank forwards proxies to the investment managers to be voted was not established until mid-May. The procedure appears to be working satisfactorily.

Trading and brokerage commissions averaged below 3 cents per share. S&P Index trades were at 1.5 cents, Large Cap Enhanced Indexers traded at 3 cents, and Small Cap managers traded at 4-6 cents. Those ranges are within acceptable ranges for large institutional portfolios.

Looking at securities lending, no violations of Investment Guidelines were detected with the exception of those of overconcentration (explained by the liquidation of the bond portfolios). Lending efficiency and income generation appeared to be lower than results obtained in 1998. Meaningful comparisons of utilization and lending efficiency were virtually impossible due to distortions caused by the liquidation of bond portfolios and the posting of equity-lending income beginning in August.

Discussion ensued concerning the matter of securities lending with full Board consensus that it was their intent that Bank One continue to lend the portfolio in their custody with Chase lending everything else and that the split of the investment managers between Bank One and Chase would not be effectuated until the Board had completed the review of the securities lending program.

9. NEXT MEETINGS

Board of Trustee meetings for the year 2000 were scheduled as follows:

February 18 (Alternate date February 29)
April 17 & 18
June 8 & 9
August 30 & 31
November 30 & December 1

10. RECESS

With no further business, the Board recessed to reconvene at 8:30 a.m. on December 10.

MINUTES

BOARD OF TRUSTEES
PUBLIC EMPLOYEES' RETIREMENT FUND
143 West Market Street, Suite 500
Indianapolis, IN 46204

December 10, 1999

TRUSTEES PRESENT

Richard Doermer, Chair
Nancy Turner, Vice Chair
Dr. Teresa Ghilarducci
Steven Miller
Jonathan Birge

OTHERS PRESENT

Mike Gery, Executive Assistant to the Governor
Steffanie Rhinesmith, Indiana Development Finance Authority
Mary Beth Braitman, Ice Miller Donadio & Ryan
Kris Ford, Wm. M. Mercer Investment Consulting
Nicole Stallbaumer, Wm. M. Mercer Investment Consulting
Pete Keliuotis, Wm. M. Mercer Investment Consulting
Louis Finney, Wm. M. Mercer Investment Consulting
Chris Levell, Wm. M. Mercer Investment Consulting
Richard Boggs, Burnley Associates
Doug Todd, McCready & Keene, Inc.
Karen Franklin, National City Bank
E. William Butler, PERF Executive Director
Mark Webb, PERF Deputy Director & General Counsel
Bill Hutchinson, PERF Division Director, Pension Administration
Linda Stahl, Recording Secretary

1. INVESTMENTS

Investment Committee Report

Steve Miller, Chair of the Investment Committee, reviewed that after an exhaustive fixed income manager search, it was the recommendation of the Investment Committee that ten of the firms interviewed be retained as fixed income managers. Those firms were then approved for retention by the full Board of Trustees as follows:

Passive

Lincoln Capital Management
Northern Trust Quantitative Advisors

Core

Black Rock
Conseco Capital Management
Reams Asset Management Company
Western Asset Management

Minority and Women Owned

Hughes Capital Management
Seix Investment Advisors
Taplin, Canida & Habacht
Utendahl Capital Management

It was also noted that three firms; HM Capital Management, Pacific Investment Management, and FirstTrust Indiana; had expressed dissatisfaction with the fact that they were not among those selected for fixed income management. The point made to all the firms was that they were not terminated for cause or for any sort of failure or underperformance. It was simply a comparative choice the Board had to make. When consideration was given to the amount of assets to be committed to fixed income management and the number of positions that were to be filled, it made the competition for those positions very intense. One of the aforementioned firms also expressed concern that as an Indiana-based firm, they should have been given consideration. It was explained further that an “if as good” policy was used throughout the search wherein an Indiana-based firm was given preference when they were otherwise equally qualified with a firm that was not Indiana based.

Future meetings of the Investment Committee were scheduled for:

January 19
March 7
March 30

Manager Transitions

Kris Ford, Wm. M. Mercer, reported that following a discussion between Karen Franklin, National City Bank; Mark Webb, PERF; and representatives of Mercer, it was determined that manager transitions should be effectuated no later than December 1. A timeline was then drawn for implementation of the transitions (completion of contracts, manager notifications, forwarding of securities, etc.), and everything has moved on schedule. There were virtually no problems, which was a remarkable feat in that almost $4 Billion was moved and all manager accounts with the exception of one had something happening to it. The last piece of the puzzle will be in place by December 13, and that will be moving the additional cash positions from the old Bank One/NBD account to Northern Trust, which they have agreed to monitor and oversee at no additional cost until the eventual disposition of that account. Managers have been notified that trades should be settled on or before December 20 and they should not begin trading again until January 5.

Performance Report

Ms. Ford continued with the investment performance report (report on file) and noted that the equity market fell during the 3rd quarter while bonds posted some positive numbers, although rising interest rates kept the gains minimal.

Looking specifically at the PERF portfolio (the Consolidated Retirement Investment Fund or “Consolidated Fund”), the total fund had a negative return for the 3rd quarter. Approximately 50% of the total Fund is now invested in equities even with the depreciation in the equity markets. Currently, the total domestic equity exposure is 85% in Large Cap and 15% in Small Cap. Thus, there is a span across the equity markets that looks somewhat similar to that of the capitalization structure. About 80% of the Large Cap exposure is indexed, which is a very good position because of the efficiencies of the Large Cap market. Approximately 9% of the domestic equity exposure is in the Small Cap markets.

Ms. Ford also reported that the nine month rate of return for the Consolidated Fund is 1.4%, and that raised some concern with the Trustees with respect to the Guaranteed Fund. It was noted that because of the move into equities, the nature of the PERF portfolio has changed dramatically and there may be time periods when the Guaranteed Fund will drastically underperformed the guarantee on that fund. That would cost the Fund in whole to benefit those people who had opted into the Guaranteed Fund. That could be compounded by those times when people move more money into the Guaranteed Fund because they see the equity returns are down. Thus, it was recommended that the Board begin an educational process to bring the return established for the Guaranteed Fund more in line with the reality of the capital markets.

Ms. Ford continued with the investment compliance report by noting that all equity managers were well ahead of their index benchmarks when you look at the 9 month and 1 year returns. The only manager the Board might want to watch is Brinson Partners, Inc. There are organizational issues with the firm, and they have some products that are under stress in terms of their performance.

Asset/Liability Study

Louis Finney and Chris Levell, Wm. M. Mercer, were present to discuss the preliminary asset/liability modeling study results for 1977 Police Officers' and Firefighters' Fund (report on file).

Prior to presentation of that report, Kris Ford reviewed that when the Board of Trustees met in October, they set specific objectives for each of the funds managed by PERF. An asset/liability modeling study is a management tool with the thrust to make an asset allocation decision that will support the liabilities. The idea is to try to marry the two together as long-range strategic type decisions are made. The broad picture is that assets are to provide benefits to workers of the State of Indiana and secondarily to minimize the burden and risk to taxpayers. If the assets and liabilities become extraordinarily mismatched, more assets have to be added to provide benefits.

With that said, Mr. Levell began the report by noting that one of the things Mercer often does to help select portfolios and to look at the characteristics of a plan is to review the surplus (i.e. assets minus liabilities) of the plan, how that surplus is expected to grow, and how volatile that surplus is. When you include liabilities in a surplus and look at the volatility of the liabilities and how they match with the assets, that becomes a surplus optimization exercise. That changes the frontier, and when the frontier is shifted, different asset classes look favorable. It was noted that utilization of this tool will be better applied to the PERF fund than the 1977 Fund in that when the employer contribution rate falls below 21% for the '77 Fund, the benefits are increased and the contribution rate, therefore, is raised back to 21%. That is a feedback that overrides surplus optimization.

Looking at the stakeholders to be considered when designing an investment program, the following were identified:

- Active Members
- Retired Members
- Beneficiaries
- Taxpayers
- Legislature
- Trustees
- Employers
- Executive Branch
- Vendors
- Staff

Each will have a different view of what will define success. There are going to be some objectives in common, and the challenge is to design an investment program that will satisfy all those objectives. The Management Study objectives defined for the 1977 Fund were as follows:

- Maintain contribution stability, recognizing that benefits will be increased should employer contributions fall below 21% of payroll
- Improve benefits as available
- Maintain/improve the actuarially determined funded status

In summary, Mercer observations for the 1977 Fund were:

- A surplus efficient frontier approach is not directly applicable due to the feedback loop of contributions on benefits. However, it does demonstrate the impact of the asset allocation decision on economic funded status.
- It is expected that employer contributions will rise slightly in the next 10-20 years. That increase could be slowed and contribution volatility reduced by decreasing equity exposure and diversifying fixed income into TIPS (inflation-index bonds). Real estate can also offer risk reduction, but not as well as TIPS. Lengthening the bond duration and/or increasing equity exposure will increase contributions and make them more volatile. International equity offers some diversification benefits as well.
- The funded status is relatively stable in the 90-110% range for all the alternative asset allocations.
- Benefits are expected to increase 50% over the next 20 years.

With respect to the 1977 Fund, it is Mercer's recommendation that the Board explore the ability to establish individual allocations for PERF and the '77 Fund, if necessary. Other fund reports will be discussed at the February 2000 meeting of the Board of Trustees.

2. <u>ADJOURNMENT</u>

There being no further business, the meeting was adjourned.